The Kobeissi Letter

Week of September 12th, 2022

Stocks snap three week losing streak but September 20th Fed meeting remains in focus

The S&P 500 closed the week 3.64% higher, at 4067, after a much needed relief bounce began, but investors remain focused on the upcoming Fed meeting. Beginning on the fundamental front, last week's rally was not really characterized by any significant fundamental development. At a high level, we have just concluded Q2 2022 earnings season where expectations were beat but guidance was weak. The biggest uncertainty in the markets right now is what happens between now and the end of this year. After three straight weeks of selling as markets adjusted to a more hawkish than expected Fed, we do not believe that we are in the clear yet. As we had written in the summer months, we believed that the rally of the June low was premature and assumed that the Fed would take a more "middle of the road" approach. However, the Jackson Hole meeting was a reminder that the Fed must remain pedal to the metal and raise interest rates rapidly to minimize the long term damage of inflation. Adding to the situation is the ongoing energy crisis in Europe and the war between Russia and Ukraine nears that half-year mark. Russia is now burning over $10 million in natural gas inventories per day and has completely halted the Nord Stream pipeline. This makes the Fed's job of taming inflation even more difficult because supply-side inflation is likely to exceed expectations with these new developments. While the Fed's efforts on the demand side are certainly beginning to help tame inflation, they are likely going to need to turn even more hawkish now to account for continued supply-side inflation. Therefore, we continue to believe that the fundamental narrative supports the bearish thesis at this time and also believe that rallies will be sold. Until we have evidence that inflation has peaked and that the Fed is toning back their hawkish rhetoric, we believe that rallies in stocks will be sold. Turning to the technical picture, we can see that the most recent uptrend was invalidated after the break below 4080 two weeks ago and the first lower low formed last week, at 3887. This came with vastly oversold technical conditions including a test of ~33 support in the daily RSI, a cross below the daily bottom Bollinger Band, and six out of seven daily candlesticks in deep red territory. The rebound off 3887 has led the daily RSI above ~40 downtrend resistance but the S&P 500 now trades in a crucial supply zone from 4050 up to 4080. In the week ahead, we emphasize the importance of the 4080 level as that is a battleground level for both bulls and bears. We believe that a near-term rejection of 4080 is the most likely path and this would open for the second major lower high, with the previous being at 4203 on August 26th. Therefore, we remain bearish of the S&P 500 with a 3950 target and 4125 stop-loss.

Oil prices in volatility as Russia threatens supply halt

WTI crude (October 2022) closed the week 0.99% lower, at \$86.18, despite a surprise OPEC+ production cut and threats from Russian President Vladimir Putin to halt oil and gas exports to Europe if price caps are imposed. On Monday, OPEC+ agreed to a production cut to bolster prices that have slid on fears of an economic slowdown. The producers will cut output by 100,000 barrels per day, amounting to 0.1% of global demand, for October. Meanwhile, the weaponization of energy resources continued between Russia and Europe. However, despite all of these bullish factors, crude oil prices continue to slide. This leads us to believe that the dominant narrative in the crude oil markets is inflation, the Fed, and the U.S. Dollar. As the Dollar continues to strengthen and hawkish Fed expectations rise, it is difficult to see a case for a prolonged rally in the commodity. We believe that the fundamental narrative is pointing lower over the near-term and have now turned bearish. When turning to the technical picture, we first see a test of the top end of long term downward trending channel support last week, at \$81.20, which held for two consecutive daily candlesticks. This came with a cross below the \$81.95 daily bottom Bollinger Band and a bounce off ~35 support in the daily RSI. The bounce off the channel led to a close above \$86.00 and appears to be ready to form another lower high.While the August 30th high technically invalidated the downtrend stemming from mid-June, the September 5th high, at \$90.37, is now serving as the most recent lower high which we believe will prolong the downtrend. We have also seen both the daily top and bottom Bollinger Bands shift lower, to \$96.98 and \$81.60 respectively, which suggests that momentum is still pointing lower. Looking ahead, we believe an early reversal this week will solidify a lower high and open for a retest of the trendline at \$80.00. Therefore, we are bearish with an \$80.00 target and \$90.00 stop-loss.

Natural gas falls to key technical level as bulls defend

When looking at natural gas (October 2022) the commodity ended the week 10.12% lower, at \$8.00, as recession fears and lower demand outlook outweighed ongoing supply shortages in Europe and geopolitical tensions between Russia and Ukraine. Meanwhile, the EIA released their latest projections last week and raised their outlook to say that spot prices will average roughly \$9/MMBtu during the fourth quarter. While the fundamental picture is mixed at a high level, we continue to believe that it favors bulls as supply disruptions are here to stay and weather surprises to the upside. We also believe that the majority of last week's decline was driven by technical factors rather than large fundamental shifts. When turning to the chart above, we see that the decline began after key uptrend support was broken at \$8.90 on September 6th. This came after a rejection of ~60 resistance in the daily RSI as well as a backtest of that trendline which was rejected. The large gap lower led below \$7.00 to a weekly lower of \$7.75 which is now a level that bulls are attempting for a higher low around. We saw four consecutive crosses below the daily bottom Bollinger Band which closed last week at \$7.88, and the daily RSI also bounced directly off ~40 support. Furthermore, we saw the daily top Bollinger Band actually shift higher last week, at \$10.01, and the September 6th gap lower is now at risk of being filled. Natural gas price action has been characterized by the large unfilled gaps to both directions all year which helps explain why we are seeing such violent swings almost every week. Looking ahead, the most important level of support to hold is that August 8th low, at \$7.53. If bulls are unable to hold that level, we believe that the recent rally will conclude and a test of \$5.30 support from late-June becomes a possibility. However, we believe that bulls are still in control for now and we remain bullish with an \$8.75 target and \$7.50 stop-loss.

Gold inches higher as U.S. Dollar attempts higher low

Gold prices (December 2022) closed the week 0.41% higher, at $1729/oz, as the U.S. Dollar Index (DXY) retreated off its highs in a much needed pullback. We saw DXY reach as high as 110.79 last week before dropping into the close on Friday as the daily top Bollinger Band turned lower, to 110.72. However, the index remains above its most recent higher low, at 107.59 from August 26th, and the daily bottom Bollinger Band has shifted rapidly higher to close the week at 106.50. As hawkish Fed expectations continue to rise and DXY trades in a sharp uptrend, we believe a higher low is set to form in the index and lead gold prices below $1700 next. Fundamentally speaking, the recent uptick in market volatility has not been able to support gold prices as hawkish Fed policy is being prioritized over safe haven investment demand. In a period with rising interest rates and the goal of inflation reduction, gold has difficulties shining. Fundamentally speaking, we believe that the current backdrop remains highly bearish and the next leg lower is set to begin over the next couple of weeks. When turning to the technical picture for gold, it appears that we traded largely in technical consolidation over the last week or so after making the most recent lower low, at $1699 on September 2nd. This low came with a bounce off ~30 support in the daily RSI, a cross below the $1713 daily bottom Bollinger Band, and a move off the bottom end of near-term downward trending channel support. Last week, we saw the top end of that channel rejected, at $1735, the daily RSI rejected ~45 resistance, and both the daily top and bottom Bollinger Bands shifted sharply lower, to $1810 and $1695 respectively. Given the potential higher low in DXY and the continued downtrend in gold, we believe that a lower high has already formed and bulls are unlikely to break the previous higher low, at $1780 from August 25th. We remain bearish with a $1670 target and $1760 stop-loss.

Treasury yields hit new highs as ECB targets inflation

The yield on the ten year note closed the week 12 basis points higher, at 3.32%, following the European Central Bank's interest rate hike. Meanwhile, Federal Reserve Vice Chair Lael Brainard in a speech Wednesday vowed to continue the fight against inflation "for as long as it takes. So far, we have expeditiously raised the policy rate to the peak of the previous cycle, and the policy rate will need to rise further," she said. Bond markets remain in volatility as investors look ahead to the September 21st Fed meeting which will set the tone for interest rate hikes into the end of 2022. As we have written previously, we believe the late-Summer rally in stocks and pullback in treasury yields was premature which has proven to be the case. The Fed cannot afford a "middle of the road" outlook and must remain full speed ahead with hawkish policy in order to minimize long term damage of historically high inflation. We continue to believe that the near-term picture for treasury yields is bulls given the aforementioned. Turning to the technical picture, we saw a brief relief bounce early last week which formed the most recent lower high, at $110.56 on September 2nd. This came with a bounce off of ~31 support in the daily RSI as well as a cross below the daily bottom Bollinger Band on September 6th, at $108.32. Since then, we have seen the daily RSI rise towards 40 while both the daily top and bottom Bollinger Bands continued to shift lower, to $117.17 and $107.08 respectively. Looking ahead, the only real level of support left is the June 16th low, at $108.12, which we expect to be broken this week. As long as the daily bottom Bollinger Band continues to drop and the daily RSI avoids severely oversold territory, we believe the trend is pointing sharply lower in TLT and all rallies ahead of the September 21st Fed meeting are likely to be sold. Therefore, we remain bearish of TLT and have lowered our target to $104.00 and stop-loss to $114.00.

Summary of Analysis

1. Bearish of S&P 500: Until the September 21st Fed meeting, we expect hawkish Fed expectations to rise and rallies to be sold. Dovish Fed expectations going into August continue to disappoint and we believe the September Fed meeting will reaffirm the hawkish view. We now see the S&P 500 approaching the key 4080 level where we expect a lower high and now stand bearish with a 3950 target and 4125 stop-loss.

2. Bearish of WTI Crude: While supply-side factors have shifted in the bullish direction, hawkish Fed expectations and a strengthening U.S. Dollar are clearly the dominant fundamental drivers of this market. We are looking for a lower high this week, to build on the September 5th lower high at $90.37, and now stand bearish of the commodity with an $80.00 target and $90.00 stop-loss.

3. Bullish of Natural Gas: The fundamental backdrop continues to develop in a mixed way as the technical setup takes the lead. As mentioned, as long as we remain above the $7.53 low from August 8th, we believe that bulls are attempting a higher low around $7.75. The daily top Bollinger Band has shifted higher and the daily RSI bounced directly off ~40 support. We remain bullish with an $8.75 target and $7.50 stop-loss while looking for early upside.

4. Bearish of Gold and Gold Miners: A pullback in the U.S. Dollar Index (DXY) was well overdue and appears to have formed a higher low above the previous major higher low, at 107.59. We view the fundamental backdrop as strongly bearish for gold as rates are rising and DXY is set to strengthen even more. We remain bearish of the commodity with a $1670 target and $1760 stop-loss.

5. Bullish of U.S. Treasury Yields and Bearish of Bonds (ETF Ticker: TLT): Our bearish thesis in TLT has played out perfectly, and we believe it is set to continue. We expect hawkish expectations in the September 21st Fed meeting to rise and TLT just formed its most recent lower high, at $110.56 on September 2nd. The only level of support left is the $108.12 low from June 16th, and we remain bearish with a new target of $104.00 with a $114.00 stop-loss.

Keep your OPTIONS Open

For this week's options market setup, we take a look at Ford Motor Company (F) as the automotive industry continues to battle supply chain issues, a historically hot car market, and the transition to electric vehicles. The stock has traded in volatility over the last few weeks after announcing plans to layoff 3,000 workers in August and a lawsuit that potentially leaves Ford on the hook for $1.7 billion in punitive damages. In the August 19th decision, the jury unanimously said Ford was responsible for the deaths of a Georgia couple after the roof of their 2002 Ford F-250 collapsed in a 2014 rollover crash which opened the door for significant legal liability. Fundamentally speaking, Ford is looking better as they transition to electric vehicles, but we believe near-term headwinds in their supply chain and falling demand will begin to weigh on their earnings. When turning to the technical picture, Ford, along with the broader equity markets, saw a nice rally off the July 5th low, at $10.61, which led to a high of $16.68 on August 16th. This came with a steep cross above 75 in the daily RSI as well as a break below its previous higher low, at $15.15. Since then, the daily RSI has been strongly downward divergent and now trades at ~54, well above oversold levels. We believe this downward divergence along with the daily top and bottom Bollinger Bands trading flat is a clear indication of a shift in momentum. Looking ahead, the rally into Friday has already begun to fade and we believe the $15.70 high from Friday will form the most recent lower high. It also aligned with a lower high at ~57 in the daily RSI and now opens for a break below last week's low, at $14.78. With that in mind, we are now bullish of the October 21st, $15.00 strike puts which closed last week at $0.65. These options reflect a 4.2% premium with an implied volatility of 45%.